THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

National Intelligence Council

DDI#3209-82
19 April 1982

MEMORANDUM FOR: James L. Buckley
Under Secretary of State for Security
Assistance, Science and Technology

FROM: Maurice C. Ernst
National Intelligence Officer for Economics

SUBJECT: Background for Discussion with Allies of Impact of Soviet Hard Currency Problems on Soviet Military Effort and Soviet Options for Hard Currency Allocations

1. In recent months the Soviet hard currency problem has resulted in cutbacks in imports of Western goods and other hard currency expenditures. Although there is little clear information on cuts bearing directly on military programs, the civilian cutbacks are so broad that military programs are probably being affected. This is especially true given the growing weakness and extraordinary tautness of the Soviet economy.

2. As the Soviet hard currency problem developed during 1981, Moscow delayed payments for imports and reduced purchases of certain non-critical items, including civilian machinery and chemicals. Now there are indications the Soviet authorities are moving to curb imports in a broad brush fashion reminiscent of their actions during the hard currency crunch of the mid-1970s.

3. Specifically, major Western exporters of industrial goods to the USSR have been notified that Soviet purchases are about to be reduced or delayed. There is also evidence that Soviet trade organizations are to cut expenditures for plant and equipment imports by about one-third. Furthermore, there is evidence that non-grain food imports are being cut. Contracts for spare parts for existing Western built plants are also being canceled as they come up for renewal.

4. Although there is little clear evidence to suggest that imports of direct importance to Soviet military programs have been reduced, the broad brush reductions evidently are affecting trade ministries long associated with the procurement of Western goods in support of Soviet defense programs. For example, Soviet trade officials concerned with the purchase of advanced Western technology for both civilian and military applications have revealed that they are under orders to refrain from placing major orders.

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5. The fact that such organizations have not been exempted from hard currency spending cutbacks suggests that other priority industries, including defense related industries, may also be under hard currency spending restrictions. No doubt, top priority programs have been exempted from the cuts but many high priority programs could very well be affected--especially if the Ministries have to justify exemptions from the cuts on an individual basis.

6. There are indications that the Soviet economic malaise has already forced the Soviets to take a harder look at expenditures on technical assistance abroad. Hard currency problems can only make more difficult the choices associated with this one aspect of Soviet foreign policy.

7. Soviet efforts to boost hard currency earnings by curbing oil exports to the East Bloc countries has also reflected on the Bloc's military capacities. Cutbacks in oil shipments to East Germany are reportedly responsible for a cut in consumption of petroleum-based fuels and lubricants by the East German armed forces for their training program.

8. To date, the Soviet response to hard currency problem has been essentially a short-term response. As further cuts become necessary, such as those that would result from Western measures limiting credit availability to the USSR, the Soviet government will have to review its priorities.

9. The programs likely to come under the strictest review are those that depend most heavily upon Western goods and technologies. Although imports of hard currency items from the West are equal to only 1.7 percent of Soviet GNP, they are very important to specific sectors of the economy. For example:

- Imports of Western machinery are equal to more than 10 percent of Soviet capital investment in equipment. The one-third reduction in plant and equipment expenditures cited above could cut total capital investment by a noticeable amount.

- Soviet output of many advanced chemical products is produced mainly in plants equipped with machinery and technology acquired from Western suppliers. Western machinery and technology roughly account for three-quarters or more of productive capacity for polyester fibers, and polypropylene, two-thirds for acrylic fibers and ammonia, over one-third for caprolectum, polyvinyl chloride and complex fertilizers. Spare parts for these plants also are important.

- Most of the Soviet micro-electronic industry--a sector of high importance to the Soviet military effort--has been built with Western production equipment, machinery and technology. Continued access to Western machinery and technology will be important for further expansion.

- Most of the multi-axis machine tools with numerical program controls in use in the USSR have been imported from the West. Continued access to advanced Western machine tools is essential to the modernization of Soviet industry.

- Western help has been vital to the ambitious 15-year program of modernization and expansion of the Soviet motor vehicle industry.

- Bauxite imports account for about one-half of the alumina content required to supply the Soviet aluminum industry.

10. No one can predict which programs would be cut, but it is clear that substantial cuts in any major industrial program would have repercussions throughout the Soviet economy. Even the defense industries probably could not be insulated because of the extraordinary tautness of the Soviet economy.

/ Maurice C. Ernst

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